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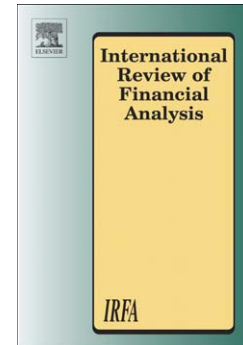
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Diversification or internalization?

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# Funding liquidity risk and internal markets in multi-bank holding companies: Diversification or internalization? ☆

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## Abstract

This study examines how a multi-bank holding company (MBHC) manages *funding liquidity risk* through its internal liquidity market, how its internal liquidity market works, and the benefits that its member banks enjoy. The results provide evidence that the diversification effect mostly dominates the internalization effect. A new entrant into an MBHC structure benefits from holding lower liquidity and raising deposits at lower costs than a non-MBHC structure, suggesting that MBHCs have enjoyed scant liquidity at the cost of mismatch risk. We find that other member banks also enjoy the benefits of diversified risk when a new entrant joins, suggesting that MBHCs manage liquidity in response to changes in funding liquidity risk. However, internalization is more important for MBHCs that have large numbers of subsidiaries. Whichever types of mergers/acquisitions are chosen by an MBHC, the diversification effect appears. Basel III liquidity regulations would mitigate the mismatch risk at the cost of distorted internal liquidity markets.

*Keywords:* funding liquidity risk, merger and acquisition, bank holding company, Basel III, Net Stable Funding Ratio

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